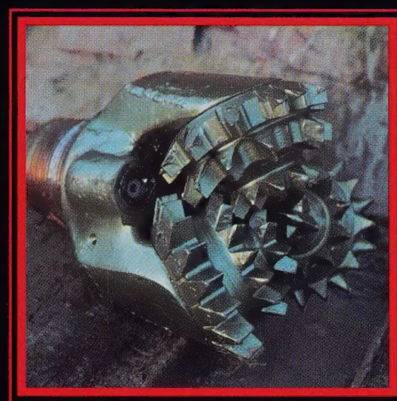

1996 Annual Report

...committed to achieving growth and creating shareholder value through oil and gas exploration and strategic reserve acquisitions.

OILEXCO
INCORPORATED

Corporate Profile

Oilexco Incorporated is a Canadian energy company committed to achieving growth and creating shareholder value through oil and gas exploration and strategic reserve acquisitions. Oilexco is currently reviewing and pursuing ventures domestically in North America as well as internationally on other continents.

Oilexco's exploration program targets high-quality hydrocarbon reserves and production in seven focus areas: the Port au Port area on the west coast of Newfoundland; the Edson area of west central Alberta; the Senex/Talbot Lake area of north central Alberta; south-east Saskatchewan; Cameron Parish, Louisiana; Monroe County, Alabama; and Monroe County, Michigan. The Company also holds an interest in and operates a number of shallow Viking Sand oil wells in the Forgan area of west central Saskatchewan.

The common shares of Oilexco Incorporated are listed for trading on the Alberta Stock Exchange and trade under the symbol 'OIL'.

Annual General Meeting

The Annual General Meeting of Shareholders of Oilexco will be held on Thursday, May 22, 1997, at 3:30 pm in the Royal Room, Metropolitan Centre, Plus 15 Level, 333-4th Avenue S.W., Calgary, Alberta.

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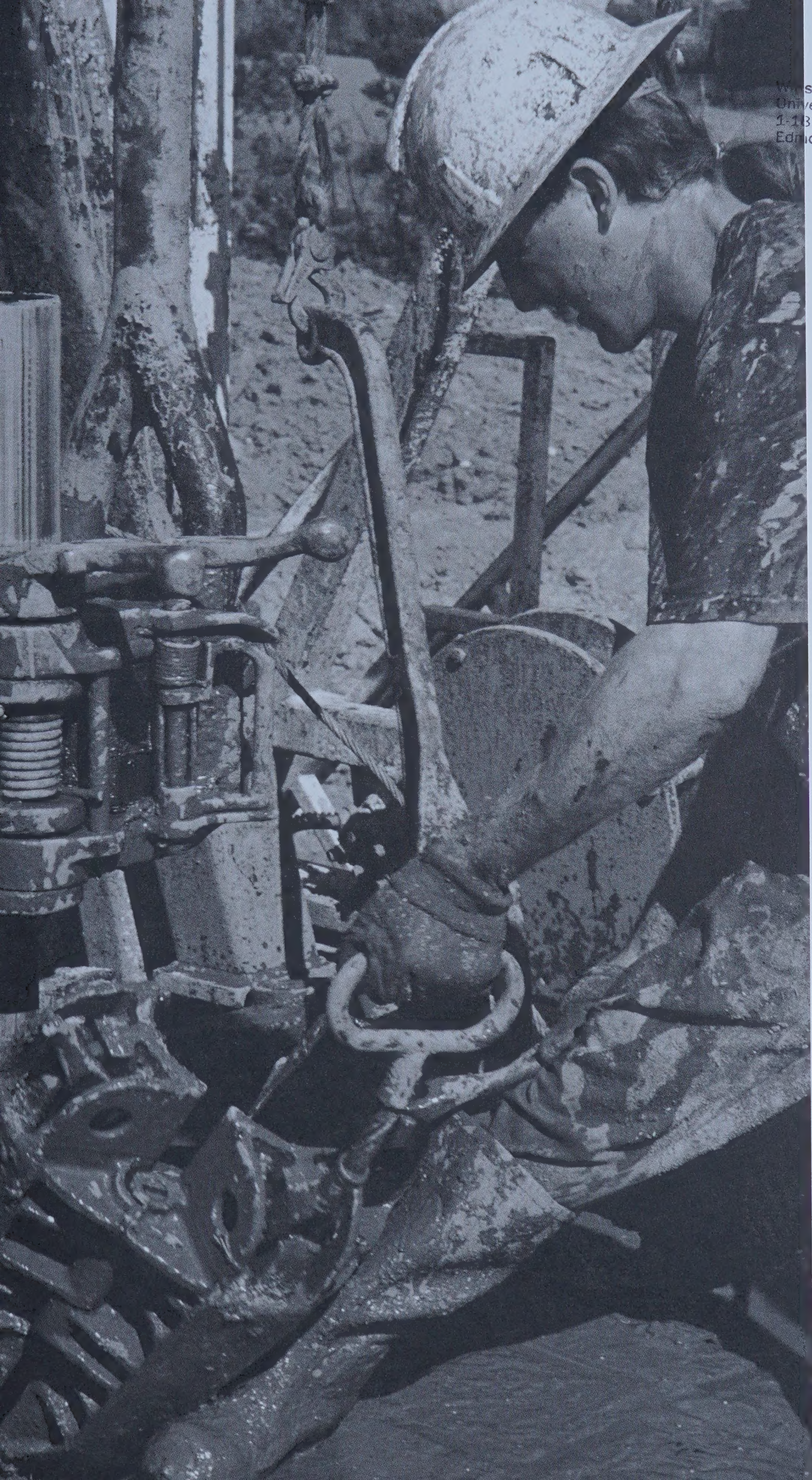
Abbreviations

Bbls	barrels
Bcf	billion cubic feet
BOE	barrels of oil equivalent (10 Mcf = 1 BOE)
Mbbls	thousand barrels
Mcf	thousand cubic feet
Mmcf	million cubic feet
NGLs	natural gas liquids
WTI	West Texas Intermediate
/d	per day



Highlights

1996 Financial and Operational Highlights Table

Financial ($000s, expect per share data)	1996	1995
Gross Revenues	979	638
Funds from Operations	76	20
per share	Nil	Nil
Net Earnings (Loss)	(4,187)	(256)
per share	(0.27)	(0.04)
Capital Expenditures	5,648	259
Bank Loan	Nil	80
Shareholders' Equity	11,529	3,308
Common Shares Outstanding (000s of shares)	16,440	7,443
Trading		
High	5.10	1.77
Low	0.68	0.135
Volume (000s of shares)	35,814	1,528

Operational		
Production		
Crude Oil (Bbls/d)	47	57
Reserves		
Crude Oil & Natural Gas Liquids (Mbbls)	178.6	192
Natural Gas (Bcf)	3.5	3.9
Barrels of Oil Equivalent (MBOE)	528	580

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1996 Performance vs. Objectives

Objective	Performance
▪ drill an exploratory well on the Port au Port prospect	▪ Long Range A-09 was drilled under budget but was abandoned because of a lack of reservoir rock in the target horizon
▪ make a strategic production acquisition with upside drilling potential in order to increase the Company's asset base and stabilize cash flow	▪ evaluated several opportunities; but, due to the increase in costs arising from the activity of royalty trusts in the acquisition market, Oilexco did not proceed, and instead, pursued oil development drilling projects such as the Vocation project in Alabama
▪ re-evaluate the Wild River Project at Edson, Alberta	▪ completed re-evaluation; will tie in 2 Wild River gas wells in Q1 1997
▪ re-evaluate the Sundance Project at Edson, Alberta	▪ recovered oil from a recompletion in the Belly River; will drill a Belly River well in Q1 1997, and shoot additional seismic over two new prospects
▪ acquire additional lands on new prospects in core areas	▪ acquired additional lands in two prospect areas at Edson
▪ farm out exploration prospects when necessary	▪ optioned prospects at Creelman/ Hartaven and Viewfield for evaluation in 1997

Letter to the Shareholders

Although the roots of Oilexco are in the Western Canada Sedimentary Basin, for the past few years the Company has also been active outside western Canada, looking elsewhere for significant growth opportunities. In 1993 Oilexco acquired exploratory property in North Dakota, and in early 1996, drilled a well in west Newfoundland. In the latter half of 1996 and early 1997, Oilexco entered into joint ventures in Louisiana, Alabama and Michigan. While the Company is still active in its core properties in central Alberta and Saskatchewan, it believes the current operating climate in the United States offers, at least in the short term, better opportunities and increased value for Oilexco shareholders.

Throughout 1995, soft commodity prices brought on by over supply and a lack of export capacity caused severely curtailed activity in the oil and gas industry. The past year was characterized by a reversal of that operating environment. An unseasonably long and cold winter throughout North America initiated a chain of events which culminated in strengthened commodity prices and improved cash flows. This, in turn, resulted in higher activity levels and increased investor interest in the oil and gas sectors. While a refreshing change from the uncertainty of 1995, the industry also saw escalating demand for, and consequently decreased availability of, acquisition opportunities, prospective land and support services. The competition for acquisition and equity capital was further intensified by the emergence of royalty trusts.

As a result of the overcapitalization and highly competitive nature of the Canadian oil and gas sector during 1996, Oilexco was prompted to expand into the United States at a time when the U.S. oil and gas sector was relatively undercapitalized. The availability of accessible interests in significant drilling opportunities in the Gulf Coast region, at considerably lower entry costs than comparative opportunities in western Canada, coupled with sub-

stantially higher U.S. gas pricing led Oilexco to pursue exploration and development opportunities in the U.S. These include:

- **South Lakeside Prospect, Cameron Parish, Louisiana:** Oilexco is targeting significant potential gas reserves in a producing area that commands the premier gas prices in North America.
- **Jurassic Park Prospect, Vocation Field, Monroe County, Alabama:** The Company has entered into an oil development project in a proven field area which also offers several deeper exploratory locations.
- **Monroe County, Michigan:** Oilexco is working with a local independent, targeting shallow oil in seismically definable Ordovician carbonates.

Drilling is planned for each of these projects in the first half of 1997.

Oilexco also plans to drill wells in 1997 at its Senex/Talbot Lake and Sundance core areas in Alberta. While wells had been planned for both of these projects in 1996, drilling did not occur due to the unavailability of drilling rigs. The recompletion of an existing well earlier in 1996 at Sundance confirmed the presence of oil, and a well to test this show will be drilled in the first half of 1997. As well, an ongoing evaluation of the Senex/Talbot Lake prospect has identified a number of potential locations and additional prospective lands. The Company plans to drill at least two wells in this area in the coming year.

The Long Range A-09 well drilled in Newfoundland last spring by Oilexco and its partners was abandoned in June because of a lack of adequate reservoir rock. The Company continues to hold a significant land position in west Newfoundland which contains a large, separate structure currently being evaluated. Drilling could take place in 1998.

Oilexco closed two separate financings early in 1996. In the first, 5,555,555 shares were issued at $0.90 per share, and in the second, 4,400,000 shares were issued at $2.00 per share. Gross proceeds totaled $13,800,000 and were used to finance the Company's

exploration activities in Newfoundland and elsewhere. Trading in Oilexco shares was very active throughout 1996 with a balanced mix of institutions and retail investors trading over 35 million shares on 16 million shares outstanding.

In 1997, the industry outlook is for activity levels comparable to those of 1996. Consequently, the lack of available drilling rigs will most likely continue for the balance of 1997. Competition for other services, for assets and for land in western Canada will also remain at their current high levels, thus further increasing the cost of participation. Although activity levels in the U.S. are also high, the operational and business climates are less competitive. Gas pricing at the Henry Hub delivery point is expected to average $2.00 US per thousand cubic feet, and oil prices should remain on the order of $20.00 US per barrel.

With this in mind, Oilexco plans to split its activity between the U.S. and western Canada, with its U.S. activity concentrated in the Gulf Coast region. Canadian activity will centre around drilling at the Company's core areas in Alberta. Oilexco also plans to evaluate exploration, development and/or production opportunities outside of North America with the goal of international expansion in the near future.

In closing, I would like to express my appreciation to our shareholders for their continued interest and support. I would also like to thank our Board of Directors for their experience and counsel, especially Denis Russell who has left the Board after providing solid advice and service to the Company during its formative years. As well, I thank the Oilexco team for their hard work and dedication. The talents and expertise of all these people help position the Company for a successful future.

On behalf of the Board of Directors,

Arthur S. Millholland,

President and Chief Executive Officer

Operations

Review

Exploration Properties

Oilexco's exploration program targets high quality hydrocarbon reserves and production in seven focus areas. In Canada, the Company participates in an exploration joint venture on the Port au Port peninsula offshore of the west coast of Newfoundland, holds interests in exploratory lands in the Edson area of west central Alberta, in the Senex/Talbot Lake area of north central Alberta and in southeast Saskatchewan. In 1996, Oilexco entered into three exploration projects in the United States: Cameron Parish, Louisiana; Monroe County, Alabama; and Monroe County, Michigan.

Port au Port, Newfoundland

Oilexco has a 12.5 percent interest in Exploration License 1008, which includes St. George's Bay located immediately south of the Port au Port Peninsula. In 1996, the Company drilled the 3,550 metre (11,650 feet) Talisman et al Long Range A-09 well which, despite reaching its target, failed to intersect reservoir quality rock in the prospective horizon. The Company continues to evaluate a separate structure offshore within St. George's Bay. A well on this structure would not likely be drilled prior to the summer of 1998.

Edson, Alberta

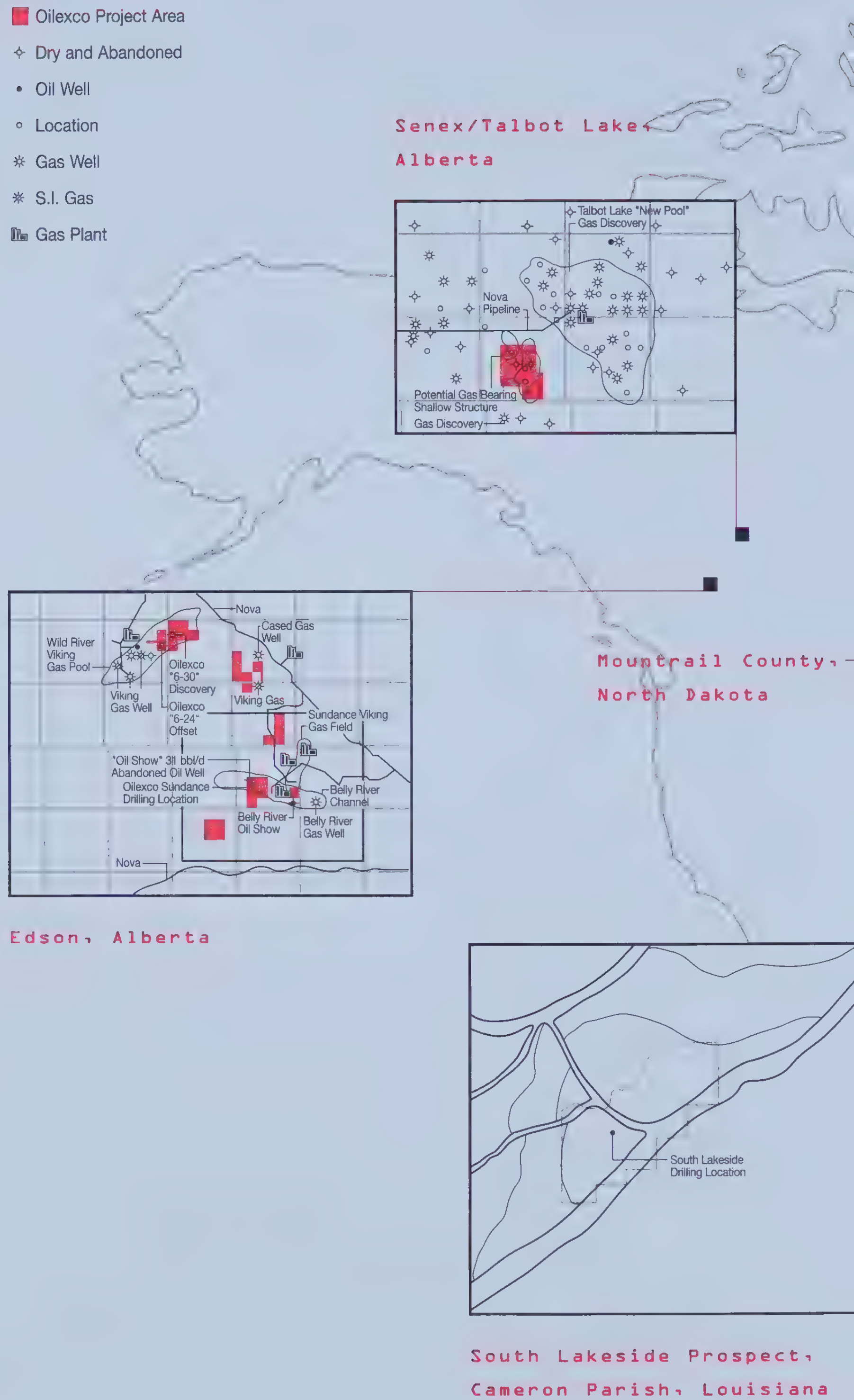
Oilexco holds interests in three projects near Edson, Alberta: Wild River, Sundance and Oldman. The Company's land contains 2.0 billion cubic feet of proven non-producing/ undeveloped gas reserves and 53,500 barrels of proven non-producing/ undeveloped natural gas liquids reserves. Probable reserves total 1.5 billion cubic feet of gas and 54,000 barrels of natural gas liquids.

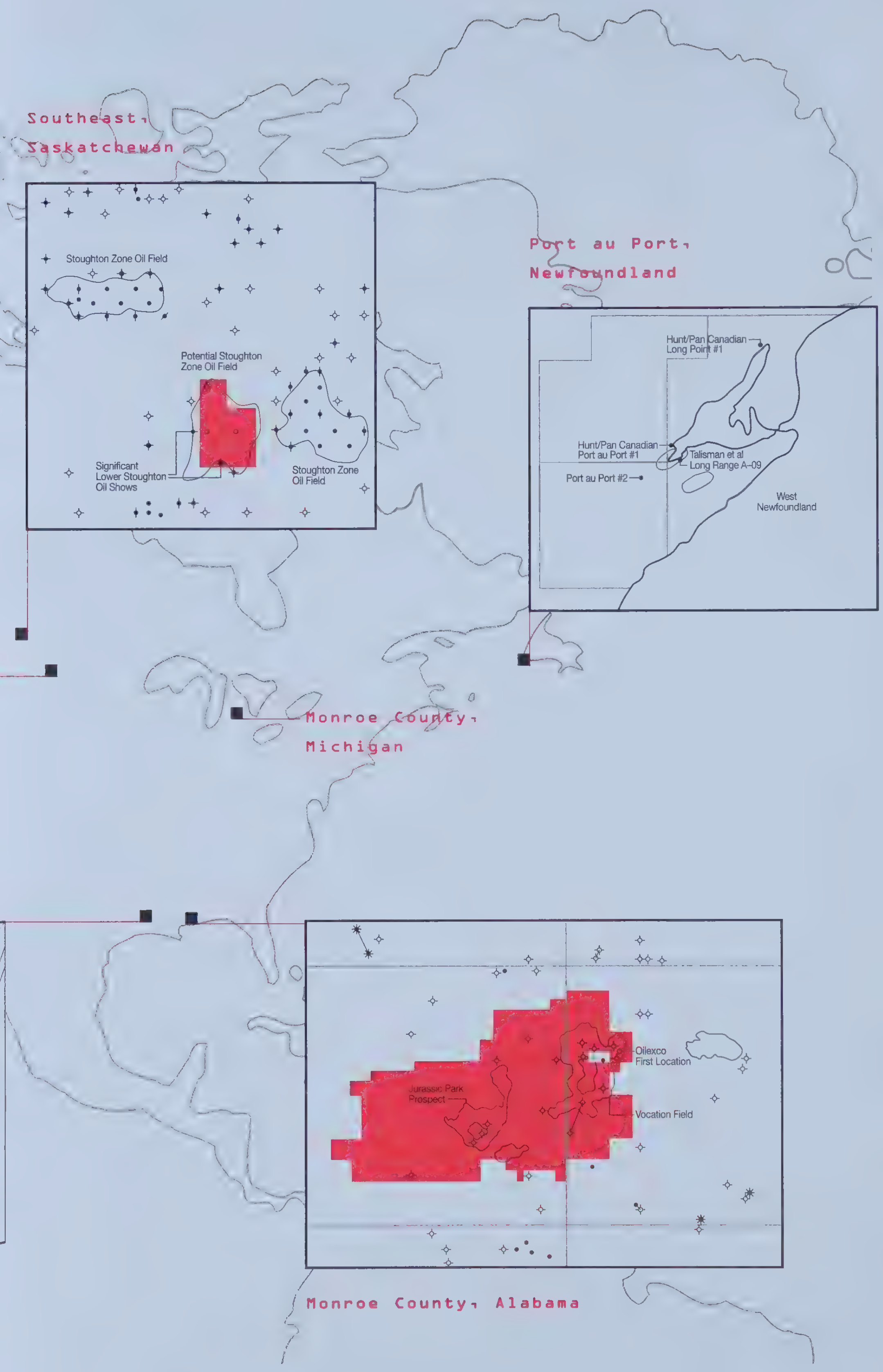
At Wild River, Oilexco holds an average working interest of 19 percent in 5,440 gross acres (1,034 net acres) containing two shut-in gas wells drilled and completed in 1994 and capable of producing from the Viking formation. Near-term plans are to tie in these two wells in 1997, and possibly drill offsetting wells in the longer term if gas prices remain stable.

Oilexco holds interests in 8,960 gross acres (2,330 net acres) at Sundance, an oil and gas prospect with the Belly River and Viking formations as primary reservoirs and the Triassic Montney as a secondary reservoir. In the first quarter of 1996, the Company recompleted an old wellbore adjacent to the prospect and recovered 38°API crude oil from the Belly River. The well was abandoned because of water influx from an adjoining zone; however, plans for 1997 include a Belly River test well offsetting a suspended 31 barrels per day show well along trend from the abandoned well. If successful, further development will proceed. A deep Triassic test could be drilled after 1997.

Oilexco holds a 19 percent interest in 4,160 gross acres (790 net acres) at Oldman, a multi-zone gas prospect targeting the Viking, Bluesky and Dunvegan formations. A seismic program is planned for 1997, and one well could be drilled depending upon the results of the seismic interpretation.

Areas of Focus





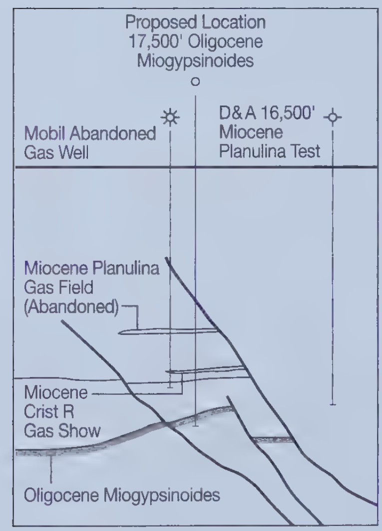
Southeast, Saskatchewan
Stoughton Zone Oil Field
Potential Stoughton Zone Oil Field
Significant Lower Stoughton Oil Shows
Stoughton Zone Oil Field
Port au Port, Newfoundland
Hunt/Pan Canadian Long Point #1
Hunt/Pan Canadian Port au Port #1
Talisman et al Long Range A-09
Port au Port #2
West Newfoundland
Monroe County, Michigan
Jurassic Park Prospect
Oilexco First Location
Vocation Field
Monroe County, Alabama

Senex/Talbot Lake

At Senex/Talbot Lake, Oilexco has a 19 percent working interest in 6,080 gross acres (1,115 net acres) of exploratory acreage. The project is a gas and oil prospect over which the Company has a 1,600 kilometre regional seismic database. Natural gas prospects are found at shallow depths of 500 to 700 meters (1,640 to 2,300 feet) in Devonian Wabamun and Lower Cretaceous Bluesky Formations. Oil prospects are found at moderate depths of 1,200 to 1,300 meters (3,940 to 4,265 feet) in Middle Devonian Granite Wash sandstones. The oil and gas targets of Senex/Talbot Lake are not exclusive and would require separate test wells. To date, five multi-zone drilling locations have been identified. Plans for 1997 include drilling two wells and acquiring additional land.

Saskatchewan

Oilexco held interests in the Creelman and Viewfield areas of southeast Saskatchewan; however, after drilling a dry hole at Creelman in the third quarter of 1996, the Company farmed out all of its acreage in these two prospects. The Company also allowed its leases in the Ingoldsby area to expire. Oilexco held a 40 percent working interest in 160 gross acres.



Cross section of Oligocene Miogypsinoides natural gas play.

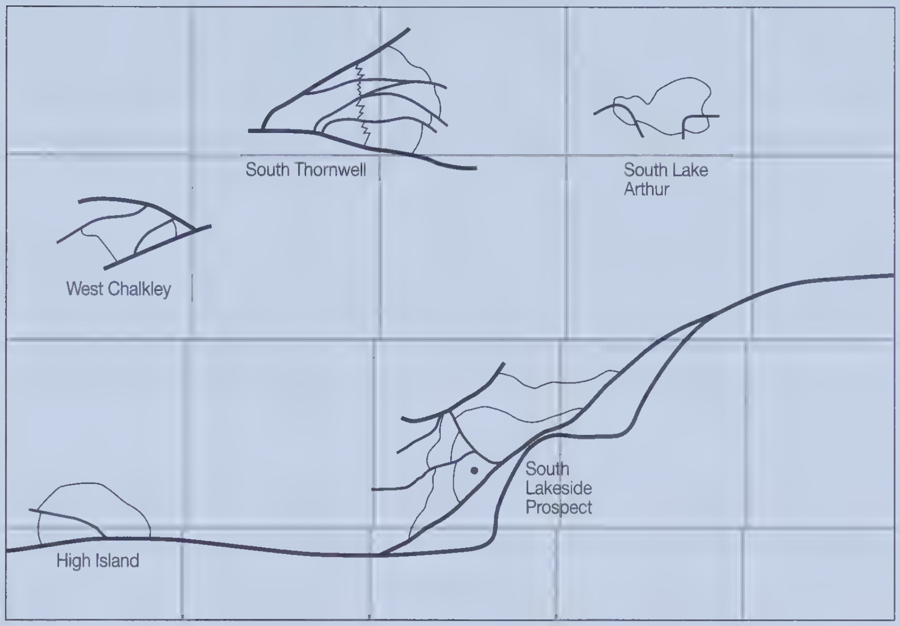
Cameron Parish, Louisiana

In August 1996, Oilexco entered into an agreement to drill an exploratory well on the South Lakeside prospect in Cameron Parish, Louisiana. The Company will pay 25 percent of drilling costs to casing point to earn a 21.875 percent working interest in a 2,313 acre block. Oilexco's share of the capital requirements for this project is estimated to be $2,590,000 Cdn. Drilling commenced in early March and should take 90 days to reach the targeted depth of 5,350 metres (17,500 feet).

The initial test well is targeting a deep-seated structure which lies below an abandoned gas field, and will test multiple Miocene and Oligocene sands, including the once produc-

tive Miocene Planulina sand. One additional Miocene sand is known to be gas-bearing through testing and log character. This zone was not exploited by the previous operator prior to abandonment in 1977.

Project upside is provided by deeper, multiple Oligocene sands, primarily the gas-prone Miogypsinoides sands from which several significant gas fields in the area produce.



South Lakeside Prospect and Miogypsinoides Gas Fields, Cameron Parish, Louisiana

If Oilexco is successful in delineating significant gas reserves, ensuing production will have immediate access to market via four competitive regional natural gas gathering systems. As well, production will also receive a premium natural gas price, based on NYMEX Henry Hub futures.

Monroe County, Alabama

Oilexco is participating as to a 12.5 percent working interest in an exploration and development program on lands within and surrounding the Vocation Field in Monroe County, Alabama. The program involves 12,200 acres of petroleum leases and options as well as a recently acquired 30 square mile 3-D seismic survey. The primary reservoir in the field is the Jurassic Smackover Formation, which produces 52°API sweet crude and is one of the

most prolific reservoirs in the Gulf Coast region. The first well in a multi-well program is scheduled to spud in late March 1997, and should take approximately 30 days to reach the targeted depth of 4,360 metres (14,300 feet). Additional wells will be drilled at a rate of one every two months.

Monroe County, Michigan

In Michigan, Oilexco and a Michigan-based independent have embarked on an exploration program which targets shallow oil reservoired in the Ordovician Trenton Limestone at depths from 640 to 730 metres (2,100 to 2,400 feet). Locations are delineated using 3-D seismic and the first well spud in early 1997, and is awaiting sidetracking operations.

Mountrail County, North Dakota

Oilexco's involvement in Mountrail County began in 1993 when the Company purchased 177,000 gross acres (88,000 net) and drilled a well which was subsequently abandoned. The bulk of these leases expired in 1995.

In the first quarter of 1996, Oilexco purchased a 50 percent interest in 8,184 gross acres (4,087 net) in Mountrail County, on-trend with the Company's properties at Creelman and Viewfield, Saskatchewan. Three multi-zone Mississippian oil prospects have been delineated through seismic. The Company plans no activity in this area during 1997, and intends to reduce its interest to not less than 25 percent through the addition of a joint venture partner.

Producing Properties

Oilexco's current oil production is from the Forgan West field in west central Saskatchewan which produces from the Lower Cretaceous Viking formation. The Company holds varying interests in 5,760 gross acres (2,901 net) and 34 oil wells. Production for 1996 averaged approximately 47 barrels per day, down from 57 barrels per day in 1995 primarily because of the field's maturity and natural decline.

Land

Oilexco holds varying interests in 214,813 gross acres of land (37,066 net acres), as summarized in the following table:

	1996			1995		
	Gross	Net	Average Interest	Gross	Net	Average Interest
Development						
Forgan, SK	5,760	2,901	50.0	5,760	2,901	50.0
Wild River, AB	5,440	1,034	19.0	5,440	1,034	19.0
Total Development	11,200	3,935	35.1	11,200	3,935	35.1
Exploration						
Alberta	19,840	4,397	22.2	19,200	4,109	21.4
Saskatchewan	5,280	2,440	46.0	5,440	2,504	46.0
Newfoundland[1]	154,262	19,282	12.5	–	–	–
North Dakota	8,184	4,087	50	8,184	4,087	50.0
Michigan	1,534	894	58.3	–	–	–
Louisiana	2,313	506	21.875	–	–	–
Alabama	12,200	1,525	12.5	–	–	–
Total Exploratory	203,613	33,131	16.3	32,824	10,700	32.6
Total	214,813	37,066	17.25	44,024	14,635	33.25

1 Oilexco earned a 12.5 percent interest in 440,000 gross acres (55,000 net) upon reaching target depth of the Talisman et al Long Range A-09 well. Subsequently, the partners agreed to relinquish a portion of these lands.

Drilling

Oilexco participated in the drilling of three wells in 1996. In January, the Company recompleted a well at Sundance, Alberta which tested 38°API crude oil from the Belly River formation but was abandoned due to water influx from an adjoining zone. In February, Oilexco spudded an exploratory well in Newfoundland which was subsequently abandoned in June because of poor reservoir quality. A well at Creelman was drilled and abandoned in August.

Reserves

Oilexco's total proven reserves at January 1, 1997, as evaluated by Dobson Resource Management Ltd., were 124,500 barrels of oil and natural gas liquids and 1.973 billion cubic feet of natural gas; proven and risked probable oil and gas reserves for 1996 were 178,500 barrels of oil and liquids and 3.499 billion cubic feet of gas, for a total of 528,400 BOE, as summarized below:

Reserves

	Oil Mbbls	Gas Mmcf	NGLs Mbbls
Proven Producing	53.5	–	–
Proven Non-producing	–	1,617	60.0
Proven Undeveloped	–	356	11.0
Total Proven	53.5	1,973	71.0
Risked Probables (50%)	–	1,526	54.0
Total Proven + Risked Probables	53.5	3,499	125.0

The estimated present value of future net revenues, using escalated prices and costs, before income tax and overhead costs attributable to Oilexco's net reserves are as follows:

Estimated Present Value

discounted at	0% ($000s)	10% ($000s)	15% ($000s)	20% ($000s)
Proven Producing	682	513	461	419
Proven Non-producing	2,398	1,166	894	715
Proven Undeveloped	371	188	138	102
Total Proven	3,451	1,876	1,493	1,236
Risked Probables (50%)	2,237	1,042	795	633
Total Proven + Risked Probables	5,688	2,909	2,288	1,869

It should not be assumed that the discounted value of the estimated future net revenues is representative of the fair market value of the estimated petroleum and natural gas reserves.

Management's Discussion and Analysis

Industry Overview

The operating environment during 1996 was much improved over that of 1995. Prolonged cold weather during the winter of 1995-1996 resulted in increased demand for oil and natural gas. This, in turn, caused significant reductions in natural gas storage inventories and a consequent rise in natural gas prices. Oil prices also rose, but not as dramatically.

Increased demand, improved pricing and the emergence of royalty trusts led to a substantial increase in activity, which resulted in increased competition for acquisitions, land and equity capital. Costs for services also escalated and rig availability became constrained to the point that drilling programs were seriously impacted.

These factors prompted Oilexco to investigate opportunities in the United States where, although activity levels are high, the business climate and competition are more amenable to companies Oilexco's size. The Company remains active in its Canadian core areas, but believes the potential return on investment is greater in the U.S.

Financial Review

Oilexco had oil revenues before royalties of $490,180 in 1996, a 5.4 percent increase from $464,991 in 1995. This was primarily due to the increase in oil prices realized in 1996. Sales of crude oil averaged 48.3 barrels per day in 1996, representing a 14.2 percent decrease from 65.3 barrels per day in 1995 due to the natural declines in the Forgan area.

Other revenue in 1996 increased to $489,289 from $172,877 as a result of the $436,676 in interest earned on the funds received from the financings that took place in January 1996. This gain was partially offset by a $111,476 decrease in U.S. royalty income from 1995 due to the annualization of operations and decline of production.

Operating expenses in 1996 were $138,714 compared to $133,865 in 1995. The marginal

increase is attributable to inflation adjustment of goods and services utilized at the well site. Royalties paid were stable at $60,282 compared to $61,363 in 1995.

General and administrative expenses increased in 1996 to $693,362 from $420,372 in 1995 as a result of costs relating to additions to staff, evaluating opportunities and creating investor awareness of the Company.

In 1996, depletion and depreciation totaled $4,263,553 as compared to $298,619 in 1995. Included in depletion and depreciation for 1996 was a write-down of $4,000,000 in Canadian oil and gas properties representing dry hole expenses incurred in 1996. In 1995, the Company had written down U.S. oil and gas assets of $193,717 due to the expiration of leases and dry hole costs.

Cash flow from operations in 1996 increased to $76,409 from $20,499 in 1995. Net losses realized in 1996 and 1995 were $4,187,144, and $255,807 respectively.

Liquidity and Capital Resources

Oilexco's total capital program for 1996 amounted to $5,648,275 and was funded from internal cash flow and working capital. In 1997, the Company again intends to finance its capital program through internal cash flow, working capital and through the issuance of equity, if deemed appropriate.

At the end of 1996, Oilexco maintained its credit facility in the amount of $200,000, of which none has been utilized. The Company had working capital of $8,033,274 at December 31, 1996, and no long-term debt.

In January 1996, Oilexco closed two financings for total gross proceeds of $13,800,000 of which $1,500,000 were received on December 28, 1995. The Company realized net proceeds of approximately $12,700,000 after fees, commissions and other expenses. These proceeds were used to finance the Company's participation in its west Newfoundland drilling program and for general corporate purposes, including exploration and development in core areas, acquisition of new lands and the evaluation and possible acquisition of existing production.

During the year, upon the exercise of options and share purchase warrants, an additional $1,032,000 was raised by the Company.

Assuming all outstanding purchase warrants and options are exercised, the Company would realize additional gross proceeds of approximately $8,500,000.

Share Capital

On December 28, 1995, Oilexco irrevocably committed to issue 1,666,667 Common Shares at $0.90 per share for gross proceeds of $1,500,000 at the first closing of a 5,555,556 Common Share/Special Warrant equity issue which closed on January 17, 1996. The Company completed and closed this financing for additional gross proceeds of $3,500,000. In addition, a second financing comprising 4,400,000 Units/Unit Special Warrants, which closed January 31, 1996, realized gross proceeds of $8,800,000 for the Company. Each Unit/Unit Special Warrant entitled the holder to one Common Share of the Company and one half of one Share Purchase Warrant. One whole Share Purchase Warrant plus $2.40 entitled the holder to acquire one additional Common Share until January 31, 1997; however, the expiry date of the Share Purchase Warrants has been extended to April 30, 1997. The agents, in addition to their fees and commissions, were granted an option to purchase 600,000 shares at $0.90 per share and 440,000 shares at $2.00 per share, until January 17, 1998 and January 31, 1998 respectively, for arranging the financing.

Shares Outstanding

	December 31, 1996	March 31, 1997
Basic	16,439,888	16,774,888
New Issue	–	–
Options	1,096,000	1,652,000
Agents Warrants	1,027,500	777,500
Warrants	1,865,000	1,865,000
Fully Diluted	20,428,388	21,069,388

Corporate Stewardship

Oilexco's Board of Directors consists of four members, three of which are external directors. The Company's audit committee is composed of three members, two of which, including the Chairman, are external directors.

Although the Chairman of the Board also holds the position of President of the Company and Chief Executive Officer, Oilexco believes this situation is warranted for the present time because the Company is in the early stages of its development. As Oilexco grows, the composition of its Board and the Board's relationship to management will evolve to better reflect the TSE guidelines.

Safety, Environmental and Risk Management

As a responsible corporate entity, Oilexco continues to review its operations to minimize the environmental impact of oil and gas exploration, development and production. Oilexco is committed to the continuous use and improvement of its environmental management strategies.

All phases of oil and gas operations present environmental risks and hazards and are currently subject to environmental regulation pursuant to a variety of international conventions and federal, provincial and municipal laws, statutes, regulations, orders (including court orders), directives and guidelines. Environmental legislation provides for restrictions and prohibitions on spills, releases or emissions of various substances produced in association with certain oil and gas industry operations. It also requires that well and facility sites be abandoned and reclaimed to the satisfaction of provincial authorities. A breach of such legislation may result in the imposition of fines and penalties. In addition, certain types of operations require the submission and approval of environmental impact assessments. Environmental legislation is evolving in a manner which will mean stricter standards of enforcement, civil liability, increased fines and penalties for non-compliance

(including jail terms), more stringent environmental assessments of proposed projects and a heightened degree of responsibility for Oilexco, its officers, directors and employees. As well, the trend is away from confining liability to the polluter. Other responsible parties can include present and prior owners, tenants and others.

The Company maintains an insurance program consistent with industry practice to protect against losses due to accidental destruction of assets, well blowouts, pollution and other business interruptions. The Company believes that it is in substantial compliance with existing environmental laws and regulations applicable to it, and is not aware of any proposed environmental legislation or regulations with which it would not be in material compliance. However, the natural gas and oil industry may, in the future, become subject to more stringent environmental protection rules. This could increase the cost of doing business and may have a negative impact on earnings in the future.

Oilexco endeavours to conduct its operations in a safe and environmentally responsible manner. The Company has prepared, and uses, safety, environmental risk management and emergency response manuals developed specifically for its operations. To date, Oilexco has had no material environmental incidents or lost time accidents. As well, the Company reviews future abandonment and site restoration costs annually.

Management's Report

The consolidated financial statements and the information contained therein have been prepared by management of the Company. The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in Canada and, where appropriate, reflect management's best estimates and judgements under the circumstances. A system of internal accounting control is maintained, consistent with reasonable costs, to provide reasonable assurance that assets are adequately safeguarded and that financial information is appropriately maintained for the preparation of reliable financial statements.

The Company's independent auditor's, Arthur Andersen & Co., who are appointed by the shareholders, conduct an audit in accordance with generally accepted auditing standards to allow them to express an opinion on the consolidated financial statements.

The Audit committee of the Board of Directors, with two of the three members not being officers of the Company, meets with management and Arthur Andersen & Co. to review these statements and related financial reporting matters prior to submitting the consolidated financial statements to the Board of Directors.

Arthur S. Millholland, P. Geol.,
President and Chief Executive Officer

Dennis J. Kwan
Dennis J. Kwan, CA,
Vice President, Finance
and Chief Financial Officer

Auditors' Report

To the Shareholders of Oilexco Incorporated:

We have audited the consolidated balance sheets of Oilexco Incorporated as at December 31, 1996 and 1995 and the consolidated statements of loss, deficit and changes in financial position for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 1996 and 1995 and the results of its operations and the changes in its financial position for the years then ended in accordance with generally accepted accounting principles.

Arthur Andersen & Co.

Calgary, Alberta
March 14, 1997

Arthur Andersen & Co.
Chartered Accountants

Consolidated Balance Sheets
As at December 31

	1996	1995
Assets (Note 4)		
Current Assets		
Cash	$ 8,008,423	$ —
Marketable securities	8,000	8,000
Accounts receivable (Note 9)	508,808	1,590,807
Prepaid expenses	27,959	7,919
Inventory	8,518	8,518
	8,561,708	1,615,244
Property, Plant and Equipment (Note 3)	3,563,830	2,130,496
	$ 12,125,538	$ 3,745,740
Liabilities and Shareholders' Equity		
Current Liabilities		
Bank overdraft	$ —	$ 32,598
Bank loan	—	80,000
Accounts payable and accrued liabilities	528,434	305,322
	528,434	417,920
Future site restoration costs	68,402	19,790
	596,836	437,710
Commitments (Note 9)		
Shareholders' Equity		
Share capital (Note 5)	15,896,936	3,489,120
Deficit	(4,368,234)	(181,090)
	11,528,702	3,308,030
	$ 12,125,538	$ 3,745,740

The accompanying notes form an integral part of these financial statements.

Approved on behalf of the Board,

Arthur S. Millholland, Director

J. R. Perraton, Director

Consolidated Statements of Loss and Deficit

Years ended December 31

	1996	1995
Revenues		
Oil sales	$ 490,180	$ 464,991
Royalties	(60,282)	(61,363)
Other (Note 7)	489,287	172,877
	919,185	576,505
Expenses		
Operating	138,714	133,865
General and administrative (Note 10)	693,362	420,372
Depletion and depreciation	4,263,553	298,619
Interest	1,050	1,769
	5,096,679	854,625
Loss before taxes	(4,177,494)	(278,120)
Taxes		
Capital taxes	9,650	—
Deferred income taxes (recovery) (Note 6)	—	(22,313)
	9,650	(22,313)
Loss	(4,187,144)	(255,807)
Retained earnings (deficit), beginning of year	(181,090)	74,717
Deficit, end of year	$ (4,368,234)	$ (181,090)
Basic loss per share (Note 5)	$ (0.27)	$ (0.04)

The accompanying notes form an integral part of these financial statements.

Consolidated Statement of Changes in Financial Position
Years ended December 31

	1996	1995
Operating Activities		
Loss	$ (4,187,144)	$ (255,807)
Add items not affecting cash		
Depletion and depreciation	4,263,553	298,619
Deferred income taxes (recovery)	—	(22,313)
Funds from Operations	76,409	20,499
Changes in non-cash working capital	69,133	103,427
	145,542	123,926
Financing Activities		
Shares issued for cash	12,300,000	1,500,000
Share issue costs	(935,434)	(107,497)
Warrants exercised	815,250	—
Stock options exercised	228,000	—
	12,407,816	1,392,503
Investing Activities		
Cash calls paid (Note 9)	(364,062)	(1,500,000)
Cash calls utilized (Note 9)	1,500,000	–
Additions to property, plant and equipment	(5,648,275)	(258,661)
	(4,512,337)	(1,758,661)
Increase (decrease) in cash for the year	8,041,021	(242,232)
Cash (bank overdraft), beginning of year	(32,598)	209,634
Cash (bank overdraft), end of year	$ 8,008,423	$ (32,598)
Basic funds from operations per share (Note 5)	$ Nil	$ Nil

The accompanying notes form an integral part of these financial statements.

Notes to Consolidated Financial Statements
December 31, 1996 and 1995

1) Significant Accounting Policies

Principles of Consolidation

The consolidated financial statements include the accounts of Oilexco Incorporated and its wholly-owned subsidiary Oilexco America, Inc. (together "the Company").

Property, Plant and Equipment

The Company follows the full cost method of accounting for oil and gas properties and related expenditures, whereby all costs relating to the exploration for and development of petroleum and natural gas reserves are capitalized and accumulated in cost centres on a country by country basis. Such costs include land acquisition, geological and geophysical, drilling, equipment and facilities, carrying charges on non-producing properties and related overhead. Unevaluated properties are assessed periodically to ascertain whether impairment has occurred. When proven reserves are assigned or the property is considered to be impaired, the cost of the property or the amount of the impairment is added to costs subject to depletion. The Company has two cost centres, Canada and the United States.

Proceeds from the sale of oil and gas properties are applied against capitalized costs, with no gain or loss recognized, unless such a sale alters the rate of depletion and depreciation by 20% or more.

The costs related to each cost centre, together with the costs of production equipment, are depleted and depreciated on the unit-of-production method based on the estimated proven reserves before royalties of each country. Oil and gas reserves and production are converted into equivalent units based upon estimated relative energy content.

The capitalized costs less accumulated depletion and depreciation in each cost centre, are limited to an amount equal to the estimated future net revenue from the estimated proven reserves at year end prices and costs, plus the lower of cost or estimated fair value of unevaluated properties. On application of this test on the Canadian cost centre, a write down of $4,000,000 was required in 1996 (1995 - $Nil). On application of this test on the United States cost centre in 1996 no write down was required (1995 - $193,717). The total capitalized costs less accumulated depletion and depreciation, accrued future site restoration costs and deferred income taxes of all cost centres is further limited to an amount equal to the estimated future net revenue from proven reserves at year end prices and costs, plus the lower of cost or estimated fair value of unevaluated properties of all cost centres less future site restoration costs, general and administrative expenses, financing costs and income taxes.

Estimated future site restoration costs are provided for on the unit-of-production method based on the estimated proven reserves. Costs are based on engineering estimates in accordance with current legislation and industry practices. The annual charge is recorded as additional depletion and depreciation. Actual expenditures are charged against the accumulated provision as incurred.

Other fixed assets are depreciated on a declining balance basis at 20% per year.

Joint Interest Operations

Substantially all of the Company's oil and gas activities are carried out jointly with others. These consolidated financial statements reflect only the Company's proportionate interest in such activities.

Income Taxes

The Company follows the deferral method of tax allocation accounting for timing differences between taxable and accounting income. Timing differences arise mainly due to capital cost allowance and resource deductions claimed by the Company for tax purposes in amounts differing from depletion and depreciation expense.

Foreign Currency Translation

The accounts of Oilexco America, Inc. are translated using the temporal method. Under this method monetary assets and liabilities are translated at the year-end exchange rate; non-monetary assets and liabilities are translated at historical exchange rates. Revenue and expenses are translated at the weighted average exchange rate for the year. Exchange gains and losses from the translation of monetary items are included in the consolidated statement of loss.

2) Exploration Joint Venture

The Company has acquired petroleum and natural gas rights in Alberta through direct working interest and a carried interest from participation in an Exploration Joint Venture. The Company received a 10% carried interest in all expenditures made in the joint venture area up to and including all costs associated with the drilling, abandonment, completion and testing of the initial test well on each prospect area or until expiry of the leases. To December 31, 1996, the carried interest has amounted to approximately $611,000 (1995 - $611,000). The Company elected to participate for an additional 9% undivided working interest in all prospect area lease acquisitions not subject to the carried interest.

3) Property, Plant and Equipment

	1996	1995
Oil and gas properties	$ 8,724,785	$ 3,109,105
Tax benefits renounced to flow-through shareholders	(563,625)	(563,625)
Other	68,834	36,239
	8,229,994	2,581,719
Accumulated depletion and depreciation	(4,666,164)	(451,223)
	$ 3,563,830	$ 2,130,496

During the year the Company capitalized $242,161 (1995 - $77,107) of administrative overhead to oil and gas properties.

4) Bank Loan

The Company has an available line of credit of $200,000 which bears interest at prime plus 1.25% per annum. The loan is collateralized by a fixed and floating charge debenture in the principal amount of $1,000,000 over all assets and undertakings of the Company, a general security agreement, an environmental indemnity and an assignment of accounts receivable. At December 31, 1996 no amount (1995 - $80,000) was outstanding on this line of credit. The line of credit is reviewed annually by the bank for renewal. If the line of credit is not renewed, then any balances outstanding are due and payable on demand.

5) Share Capital

a) Authorized

i) Unlimited number of voting Common Shares without nominal or par value.

ii) Unlimited number of Preferred Shares issuable in series.

b) Issued

Common Shares:	Number	Consideration
Balance, January 1, 1995	8,426,832	$ 2,096,617
Issued for cash	1,666,667	1,500,000
Share issue costs	—	(107,497)
Cancellation of escrowed shares	(2,650,000)	—

Common Shares:	Number	Consideration
Balance, December 31, 1995	7,443,499	$ 3,489,120
Issued for cash	8,288,889	12,300,000
Share issue costs	—	(935,434)
Stock options exercised	360,000	228,000
Purchase warrants exercised	335,000	804,000
Agent warrants exercised	12,500	11,250
Balance, December 31, 1996	16,439,888	$ 15,896,936

c) Per Share Data

Basic earnings and funds from operations per share are calculated based on the weighted average number of 15,618,186 (1995 - 6,949,481) shares outstanding during the year. The effect of the exercise of stock options and warrants based on the fully diluted number of shares of 20,428,388 (1995 - 10,137,625) is anti-dilutive.

d) Stock Options

Stock options entitling the holder to purchase Common Shares of the Company have been granted to the officers, directors, employees and certain consultants of the Company. At December 31, 1996, options to purchase 1,096,000 (1995 – 545,000) Common Shares were outstanding, having an exercise price range of $0.40 to $1.77 (1995 – $0.35 to $0.63) per share. Options are exercisable for a period of five years. Stock options expire on various dates in 2000 and 2001.

The Company has reserved the 1,643,989 (1995 – 577,683) Common Shares for issuance under a stock option plan.

Subsequent to December 31, 1996, an additional 641,000 stock options which expire on January 23, 2002 were granted at a price of $1.80 per share. Also subsequent to year end, a director exercised options to purchase 85,000 Common Shares at $0.40 per share.

e) Warrants

Pursuant to the private placement memorandum dated January 28, 1994 with amendments dated February 24, 1994 relating to the sale of 600,000 Common Shares and 600,000 flow-through shares, the Company issued 800,000 common share warrants and 600,000 flow-through share warrants. Each common share warrant or flow-through share warrant entitled the holder to acquire by March 7, 1995 one Common Share or one flow-through share respectively, upon exercise together with payment of $1.50 per warrant. All of the common share warrants and flow-through share warrants expired unexercised.

On January 17, 1996 the Company closed a private placement financing for gross proceeds of $5,000,000 from the issue of 4,467,405 Common Shares and 1,088,151 Special Warrants both priced at $0.90 each. Each Special Warrant was issued for cash without restriction as to use, and is convertible into one Common Share, for no additional consideration, on the earlier of January 17, 1997 or five days after issuance of a receipt by the Regulatory Commissions for a final prospectus. The receipts were obtained on May 29, 1996. The Company received $1,500,000 of the gross proceeds of this financing prior to December 31, 1995 and recorded this as Share Capital at December 31, 1995.

On January 31, 1996 the Company closed a private placement financing for gross proceeds of $8,800,000 from the issue of 3,350,000 Units and 1,050,000 Unit Special Warrants both priced at $2.00 each. Each Unit and Unit Special Warrant was issued for cash without restriction as to use and is comprised of one Common Share and one half of one Common Share purchase warrant. Each Common Share warrant is convertible into one Common Share, for no additional consideration, on the earlier of January 31, 1997 or five days after issuance of a receipt by the Regulatory Commissions for a final prospectus. The receipts were obtained on May 29, 1996. One Common Share purchase warrant plus $2.40 entitles the holder to purchase one additional Common Share of the Company until January 31, 1997. As proposed by the Company and by a vote and acceptance by the Common Share purchase warrant holders, the expiry date has been extended to April 30, 1997.

The Company issued 1,040,000 Agents Common Share Warrants to purchase 600,000 Common Shares at $0.90 each and 440,000 Common Shares at $2.00 each until January 17, 1998 and January 31, 1998 respectively, to the Agents of the private placement financings completed.

Subsequent to December 31, 1996, 250,000 Agents Common Share Warrants were exercised at $0.90 per share.

6) Income Taxes

The income tax provision differs from the expected result obtained by applying the effective tax rate of 45.3% on Canadian operations and 25% on U.S. operations (1995 - 45.3% and 25%) to loss before taxes as summarized below:

	1996	1995
Loss before taxes	**$ (4,177,494)**	$ (278,120)
Expected tax recovery	**$ (1,876,273)**	$ (78,065)
Non-deductible crown charges	**10,322**	11,137
Non-deductible depletion	**12,620**	11,316
Unrecorded benefit of accounting losses	**1,853,331**	33,299
Actual tax provision (recovery)	**$ Nil**	$ (22,313)

At December 31, 1996, property, plant and equipment with a net book value of $612,909 (1995 - $640,749) has no cost basis for income tax purposes.

The Company has loss carry-forwards for Canadian income tax purposes of approximately $2,251,000 (1995 - $2,019,000) which expire from 1997 to 2003. The Company also has loss carry-forwards for United States income tax purposes of approximately US $143,000 (1995 - US $31,000) which expire from 2011 to 2012.

7) Other Income

	1996	1995
Other income consists of:		
Interest	**$ 436,676**	$ 3,222
Royalties	**36,819**	149,666
Other	**15,792**	19,989
Total	**$ 489,287**	$ 172,877

8) Segmented Information

The Company is in the business of oil and gas exploration and development. Foreign operations are not significant.

9) Commitments

a) West Coast of Newfoundland Exploration

The Company entered into an Agreement in December 1995 with Talisman Energy Inc. to participate in drilling an exploration well on the Port au Port Peninsula on the west coast of Newfoundland. The Agreement stipulated that all funds required for the Company's proportionate share of the project be held on deposit at a Canadian Chartered Bank "in trust", with all interest earned accruing to Oilexco Incorporated. The Company does not have access to these funds until the abandonment and site restoration of this well is completed. The total commitment for this well was approximately $3,220,000 of which $364,062 (1995 - $1,500,000) remains "in trust" and is included in Accounts Receivable at December 31, 1996.

b) Lake Misere, Louisiana Exploration

In August 1996, the Company entered into an Agreement to participate in drilling an exploration well in Cameron Parish, Louisiana. The Agreement stipulates that all funds required for the Company's proportionate share of the project be held on deposit. The well is being drilled on a turnkey basis where most risks of drilling the well to depth are borne by the contractor. The Company will be entitled to a return of unutilized funds after the completion or abandonment of this well. The total commitment for this well is approximately $2,590,000 and was paid in full in January 1997.

c) Office Rent

The minimum rentals payable under a lease agreement for premises, exclusive of certain operating costs for which the Company is also responsible, are as follows:

1997	$ 28,133
1998	29,311
1999	31,321
2000	32,152
2001	13,301
	$ 134,218

10) Related Party Transactions

The Company paid management fees of $30,000 (1995 - $72,000) in lieu of salary for the services of a senior officer to a company controlled by that officer. Management fees were paid to June 1996; thereafter the officer became an employee of the Company.

The Company pays legal fees to a law firm in which a director is a partner. Legal fees totalling $9,651 (1995 - $26,578) have been paid to this law firm in 1996.

The Company also paid legal fees to a law firm in which a former director is a partner. Legal fees totalling $90,840 (1995 - $5,209) have been paid to this law firm in 1996.

In 1996 the Company paid fees of $35,404 (1995 - $11,664) to a public relations firm in which a member of the family of an officer and director of the Company is a partner.

Corporate Information

Directors

Arthur S. Millholland (1)
President
Oilexco Incorporated
Calgary, Alberta

John F. Cowan (1)(2)(3)
Vice President and COO
CanEnerCo Ltd.
London, Ontario

J. R. Perraton, QC (3)
Partner
Field Atkinson Perraton
Calgary, Alberta

Morris Sternberg, CA(1)
Independent Businessman
Calgary, Alberta

(1) Member of the Audit Committee
(2) Chairman of the Audit Committee
(3) Member of the Compensation Committee

Management

Arthur S. Millholland, P.Geol.
President and Chief Executive Officer

Dennis J. Kwan, CA
Vice President, Finance and
Chief Financial Officer

Auditors

Arthur Andersen & Co.
Chartered Accountants
Calgary, Alberta

Bankers

Royal Bank of Canada
Calgary, Alberta

Canadian Western Bank
Calgary, Alberta

Legal Counsel

Field Atkinson Perraton
Calgary, Alberta

Transfer Agent and Registrar

Montreal Trust
Calgary, Alberta

Share Listing

The Alberta Stock Exchange
Symbol: OIL

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